

RatingsDirect®

Summary:

Newport News, Virginia; Appropriations; General Obligation

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Credit Profile

US\$75.665 mil tax-ex new money and gen improv rfdg bnds ser 2014A

<i>Long Term Rating</i>	AA+/Stable	New
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US\$18.55 mil tax-ex wtr rfdg bnds ser 2014A due 07/15/2027

<i>Long Term Rating</i>	AA+/Stable	New
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US\$6.05 mil taxable rfdg bnds ser 2014B due 01/15/2025

<i>Long Term Rating</i>	AA+/Stable	New
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Rationale

Standard & Poor's Ratings Services raised its long-term and underlying rating on Newport News, Va.'s general obligation (GO) bonds outstanding one notch to 'AA+' from 'AA' based on our view of the city's resilience during the economic downturn despite its concentration in the manufacturing sector, and its continued progress in meeting its full pension obligations. We also raised our rating on the city's appropriation-backed obligations to 'AA' from 'AA-'. The outlook on all ratings is stable.

Standard & Poor's also assigned its 'AA+' long-term rating and stable outlook to the city's series 2014A tax-exempt GO general improvement and refunding bonds; series 2014A tax-exempt GO water refunding bonds; and series 2014B taxable GO refunding bonds.

The series 2014 bonds are secured by the city's full faith, credit, and unlimited tax pledge for repayment. Officials plan to use proceeds to provide approximately \$45 million in new money to fund its capital improvement plan, and to refund GO bonds outstanding for purposes of interest rate savings over the life of the bonds.

The 'AA+' long-term GO rating reflects our view of the following credit strengths:

- A strong local economy centered in Hampton Roads with a significant defense presence;
- Very strong budgetary flexibility based on available fund balance in the general fund and funds set aside for future capital projects;
- Very strong liquidity, with strong access to external liquidity; and
- Very strong management, with strong policies and practices in place.

We believe that these strengths are partially offset by the following credit factors:

- Weak budgetary performance based on total governmental funds results in 2013 and our view of the city's deferred — albeit decreasing -- cash basis payments related to pension obligations; and
- Weak debt and contingent liability profile when pension and other postemployment benefits (OPEB) are considered.

Strong economy

Newport News, with an estimated population of approximately 180,000, participates in the Hampton Roads economy, which counts defense, shipbuilding, and manufacturing as leading economic drivers. Newport News is well positioned geographically for its role in the local economy and economic expansion in the future. The city is in southeast Virginia, on the southwestern portion of the Virginia peninsula, bordered by the James River. It is easily accessible at the interstates 64 and 664 interchange and home to the Newport News-Williamsburg International Airport; it also serves as the eastern terminus of the CSX rail system. Projected per capita effective buying income is 92% of the national average, while market value per capita is \$90,668. Unemployment averaged 6.6% in 2013, which was below the national rate.

Huntington Ingalls Industries Inc., (or Newport News Shipbuilding) and the Joint Base Langley-Eustis are major economic drivers in the region. We understand that the impacts of federal sequestration and the federal government shutdown were relatively minor — primarily affecting civilian income -- and that the shipyards continue to work on recently affirmed government contracts. Although we believe that economic concentration exists with respect to federal and manufacturing sector employment, in our view, the city did not experience employment loss to the same extent as other regions during the economic downturn. In addition, the local economy continues to diversify into other forms of manufacturing with Liebherr (mining) and Canon (robotic manufacturing and camera repair) as major local employers, as well as into healthcare through Riverside Health System.

Very strong budgetary flexibility

We view Newport News' budgetary flexibility as very strong. Unassigned fund balance and committed general capital improvement and debt service reserves — which we understand could be used for operations — represented 18% of general fund expenditures in fiscal 2013. We expect reserves to remain at least stable in fiscal 2014 (June 30 year-end) and fiscal 2015 (based on the proposed budget). The city has a history of transferring surpluses to its cash capital and special projects reserves for future project funding.

Very strong liquidity

We consider the city's liquidity position very strong: Fiscal 2013 year-end cash of \$134 million represented 27% of governmental expenditures and 233% of debt service. In our view, Newport News maintains good access to external liquidity based on its frequent GO and periodic revenue debt issuance. We believe that the city's exposure to contingent liabilities is minimal, given that 100% of its direct debt is fixed rate, and the only exposure to variable-rate debt and swap terminations relates to \$4.1 million of Economic Development Authority debt backed by the city's moral obligation pledge.

Very strong management

We consider Newport News' management conditions very strong, supported by strong policies and practices. In our view, practices are strong, well embedded, and likely sustainable. The city recently adopted a detailed five-year financial forecast for fiscal years 2015-2019, which it plans to update at least annually.

Weak budgetary performance

In our opinion, the city's budgetary performance in fiscal 2013 was weak: The general fund achieved an operating surplus of 1.1% after adjusting for capital funding, while the total governmental funds drawdown equaled 3.5% of expenditures after adjusting for bond-funded capital. Management is currently projecting a \$3.7 million general fund

surplus in fiscal 2014, which will likely be applied toward capital projects in fiscal 2015, based on the proposed budget.

We believe that the city's fiscal 2013 financial performance is somewhat weaker than suggested, given that it is not funding its full annual required contribution (ARC) for the Newport News Employee Retirement Fund (NNERF). Fiscal 2013 contributions totaled \$37 million and represented approximately 65% of the ARC. Officials are in the fifth year of a plan to build up to total ARC funding by 2017: fiscal 2014 contributions represent 73% of the ARC, and fiscal 2015 contributions are budgeted at 82%. We believe that the city's performance will improve in the next three years as it approaches full ARC funding.

Weak debt and contingent liability profile

Newport News' debt and contingent liability profile is somewhat weak, in our view. Net direct debt (net of self-supporting utility debt) was 124% of governmental revenue in fiscal 2013 and carrying charges were 11% of expenditures. Amortization is rapid, however, with officials planning to retire approximately 74% of debt outstanding in 10 years. Additional debt plans in the next two years include approximately \$49.4 million in GO debt to fund the city's long-term capital improvement plan.

The city continues to contribute to the NNERF, as well as the Virginia Retirement System. The city also provides OPEB, for which it is accumulating funds in an irrevocable trust. The city's combined 2013 pension ARC and OPEB contribution represented 13.5% of expenditures in fiscal 2013. As of June 30, 2013, the NNERF plan was 63% funded, but officials are projecting an improvement to 71% funding based on the March 31, 2014 market value and additional contributions. In addition to the plan to reach full ARC funding, Newport News has also closed the plan to new hires and additionally elicited employee contributions.

Very strong Institutional Framework

We view the Institutional Framework for Virginia cities as very strong. (See "Institutional Framework Overview: Virginia Local Governments," Sept. 12, 2013, on RatingsDirect on the Global Credit Portal).

Outlook

The stable outlook reflects our view of Newport News' very strong fiscal management, which we believe has contributed to its strong reserve and liquidity position. We believe that the city's budgetary performance and debt profile will strengthen, given its adherence to historical practices of adopting structurally balanced budgets and its plans for building up to full pension ARC funding. For these reasons, we do not expect to change the rating within the two-year outlook horizon. Precluding a higher rating at this point are what we consider below-average income levels, which in our view, are partially attributable to the lingering economic concentration in the defense sector. While not foreseen, should the city's reserve and liquidity position deteriorate substantially, we could lower the rating.

Related Criteria And Research

Related Criteria

USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013

Related Research

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: Virginia Local Governments, Sept. 12, 2013

Ratings Detail (As Of April 29, 2014)		
Newport News Sch Brd certs of part		
<i>Long Term Rating</i>	AA/Stable	Upgraded
Newport News GO		
<i>Long Term Rating</i>	AA+/Stable	Upgraded
Newport News Econ Dev Auth, Virginia		
Newport News, Virginia		
Newport News Econ Dev Auth (Newport News)		
<i>Long Term Rating</i>	AA+/Stable	Upgraded

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